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SUBJECT: GUATEMALAN ECONOMY SUFFERS THE IMPACT OF THE GLOBAL FINANCIAL CRISIS

¶1. SUMMARY: The latest round of economic indicators shows continued deterioration of the Guatemalan economy as a result of the global economic crisis. The Central Bank indicated it would revise downward 2009 economic growth estimates, currently at 3 to 3.5 percent. Remittance flows and international credit lines declined in January and February and the year-on-year inflation rate declined for a third consecutive month. The Colom Administration is working to reorient its budget to implement an economic recovery plan and to cut public expenditures in accordance with revised downward projections on tax collections. Budget cuts will disproportionately impact vulnerable communities dependent on declining remittance flows and may prevent needed expansion of Guatemala's Conditional Cash Transfer Program. Important rule of law and security programs necessary to combat the increasing influence of organized crimes and narcotics traffickers may also be threatened. END SUMMARY.

Economic growth estimates will be revised downward
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¶2. Maria Antonieta de Bonilla, President of the Guatemalan Central Bank (Banguat), signaled to the press that Banguat is revising downward the growth estimate for 2009 and that it would be below the lower limit of the 3 - 3.5 % range, the current official GDP growth projection. (Note: Private economists generally predict the growth rate will fall somewhere between 1 and 2 percent. End Note.) Banguat's forthcoming downward revision is being driven by a number of statistics that confirm mounting anecdotal evidence of a substantial economic slowdown: Imports of raw materials fell by 38.7% in January 2009 and remittances declined by 9.6% in January and by 21.7 percent in February compared to the same period of 2008. Total exports grew by only 1.2% in January. Exports to all of Guatemala's main trading partners are declining: In January, exports to the United States declined by 1.3%, to Central America by 7.2%, and Mexico by 6.1%. In addition, the apparel and textile sector, which is a major employer, reported a 30% decline in exports, and vehicle importers reported a decline of 41% in their sales in January. The Guatemalan Chamber of Industry also indicated in early February that consumption of industrial products had declined between 15 and 25% in recent months.

Deflation in early 2009

¶3. According to Guatemala's National Statistics Institute (INE), the year-on-year inflation rate slowed from 7.38% in January to 6.5% in February. For the first two months of the year, Guatemala experienced deflation of 1.01%. February was the third consecutive month of deflation in Guatemala. INE attributes declining price levels in part to reduced demand due to the global economic crisis, in part to declining international prices for food and oil, and in part to seasonal variations caused by harvest cycles of some locally produced goods such as vegetables. Nevertheless, consumers have not yet enjoyed significant price declines in the cost of basic goods sold in local markets. While the cost of the basic food basket declined by 0.5% in February, it is 18% higher than in February 2008, well ahead of the overall annual inflation rate.

¶4. Some economic analysts argue that deflation is threatening the economy, and representatives from different sectors have complained about slackened consumption since the fourth quarter 2008. As a result, pressure is mounting on Banguat to increase liquidity and reduce the leading interest rate to reactivate credit to the private Qreduce the leading interest rate to reactivate credit to the private sector. The leading interest rate has been reduced 75 basis points

this year, from 7.25% in December to 6.5% at the end of February. The Monetary Board will analyze a further reduction of the leading interest rate at the end of March.

Public expenditures will be revised downward

¶5. As a result of the sharp slowdown in the economy, budget revenues are currently running at approximately 7.6 percent below forecast levels. This is a continuation of a declining trend that began in 2008. National Tax Authority (SAT) figures show that monthly tax collections compared to 2007 began declining in November
¶2008. The 2009 budget assumes an increase in tax revenues of 15%. However, tax revenue growth was only 5.7% in 2008 and the economic slowdown makes 15% growth unlikely and budget cuts a near certainty.

¶6. The GOG is beginning to acknowledge its growing fiscal deficit. Vice Minister of Finance Carlos Barreda announced March 9 that the cabinet has started discussions to on how to cut spending and reorient expenditures toward the government's National Economic Recovery Plan. As currently forecast, the GOG will need to cut overall expenditures by approximately Q4 billion (about $505 million), or 10% of total estimated 2009 expenditures. Continued deterioration of the economy could make further cuts necessary since Guatemala possesses little capacity for deficit or other counter-cyclical spending.

¶7. According to Barreda, implementation of the National Economic Recovery plan will cost at least Q6.9 billion (about USD 871 million) and must be funded from existing resources reoriented from ministry budgets. One component of the Program is to expand Guatemala's controversial Conditional Cash Transfer program, "Mi Familia Progresa," which would receive Q1.3 billion (about USD 164 million) to cover the 125 poorest municipalities in the country.

¶8. While the GOG will reorient spending towards social programs and Mi Familia Progresa, the budget shortfall may prevent Guatemala from providing the necessary budget support to expand the program poor communities most at risk due to rapidly declining remittance income from the United States. In addition, cuts from already razor-thin budgets in other ministries to fund Mi Familia Progresa threatens funding for security-related programs needed to combat significantly increased violence and increased influence of organized crimes and narcotics traffickers.

¶9. COMMENT: Official economic data is beginning to confirm anecdotal evidence of a deteriorating economy in the first two months of 2009 as a result of the global economic crisis. Overly optimistic projections on economic growth and tax revenues are now being revised downward and it is possible that given the current level of uncertainty those estimates would need to be revised downward again in the future. Monetary and, if possible, fiscal measures are urgently needed to mitigate the impact of the crisis. END COMMENT

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